MONEYLETTER Hi-Lites
Part of the Wealth Journey

Despite Historic Inflation, Most Investors Should Remain Long

September 2022

By Brian W. Kelly, Publisher

As we roll into September—after 8 months of (mostly) pain—we've been told to expect some more.

Arguments continue whether the US economy will fall into a full-blown recession or a less severe slowdown … a "growth recession." Can the Fed engineer the "soft landing' we hear about so often? Lots of uncertainties remain.

But unless you are investing for the very short term or have an extremely low tolerance for risk, it makes sense to stay invested and maintain your equity holdings at this time. History has shown us that stock market declines—like we've seen in the first eight months of this year—have turned out to be long-term buying opportunities.

The fight against inflation

Are we winning or losing? Again, there are a variety of views. Johns Hopkins economist Steve Hanke thinks we're in for a "whopper" of a recession in 2023. In an interview on CNBC last week he pointed to a huge growth in the money supply—a result of Covid—as the culprit.

Hanke believes inflation will stick with us into 2024 for this reason. He sees the rate tapering slowly, down toward 5% by the end of 2023. "The problem we have is that the Chairman (Jay Powell) does not understand, even at this point, what the causes of inflation are and were," said Hanke. "He's still going on about supply-side glitches. He has failed to tell us that inflation is always caused by excess growth in the money supply, turning the printing presses on." Maybe Powell hasn't said it in so many words, but aggressive Quantitative Tightening by the Fed is underway to reduce the money supply.

Many other economists are forecasting a recession as the lag effect of Fed tightening works its way into the system. So far in 2022 the Fed has raised its benchmark rate four times for a total of 225 basis points. Another 75 basis points are expected later this month.

In a somewhat less gloomy forecast KPMG chief economist Diane Swonk told Bloomberg that the Fed has given up its hopes for a soft landing and is now targeting a "growth recession." A growth recession is less severe than a full-blown economic recession. Cleveland Fed president Loretta Mester described it as "an economic transition to below-trend growth in nominal output, slower employment growth, and a higher unemployment rate." Mester expects this fight to bring the fed funds rate to above four percent by early 2023, with no cuts until at least 2024.

Nobel laureate Paul Krugman thinks the Fed can curb inflation without crushing employment and the economy. According to Krugman, a series of gradual interest rate hikes should be enough to keep inflation expectations in check. "Current data suggest the need to cool off the labor market, not put it through a Volcker-style wringer," said Krugman in a recent tweet. Paul Volcker was chair of the Fed from 1979 to 1987 and was credited with ending high levels of inflation that occurred in the 1970s and early 1980s.

It will also be important to keep an eye on the November elections. If the House of Representatives and/or the US Senate swing to the Republicans, government spending is likely to trend lower, potentially lessening inflationary pressure (but suppressing GDP growth in the process).

Dropping like a rock?

Not everyone is pessimistic about the inflation picture, the economy, and the stock market. In a piece last week in MSN, Fundstrat's Tom Lee was quoted as

(continued on page 2)

Economic Snapshot

Date	Report	Current	Expected	Prior
8/10	12-Mo Consumer Prices (Jul)	8.5%	8.7%	9.1%
8/18	Existing Homes (Jul)	4.81M	4.89M	5.12M
8/19	Retail Sales (Jul)	0.0%	0.1%	1.0%
8/23	New Homes (Jul)	511K	575K	585K
8/24	Durable Goods (Jul)	0.0%	0.6%	2.2%
8/30	Consumer Confidence (Aug)	103.2	97.7	95.3
9/1	ISM Manufacturing (Aug)	52.8	52.0	52.8

Notes: The pace of price inflation slowed in July, due in large part to the decline in gasoline prices. Existing home sales dropped for the sixth straight month. Lawrence Yun, chief economist for NAR said the industry is in recession "because builders are not building. Retail sales were flat as consumers took savings at the gas pumps and spent in other areas. Note retail sales are not adjusted for inflation. New home sales dropped to their lowest level since January 2016. August consumer confidence rebounded more than expected after three consecutive monthly declines. Durable goods for July were essentially flat due to a 0.7% decline in transportation equipment. ISM Manufacturing was steady, indicating resilience despite a shift back to service spending.

(Analysis, continued from page 1)

saying inflation is starting to "drop like a rock" rather than a feather. In fact, according to Lee, some regions of the US economy are seeing outright deflation. (It should be noted that this observation was based on July reports, and that an undeniable trend has not been established in our view.)

Lee highlighted the fact that commodity prices like gas, lumber, and wheat are falling quickly, as well as chicken, beef, clothing, air fares, and used cars. He expects rents and housing costs to fall rapidly as well. About one-third of CPI (the Consumer Price Index) and 40% of core CPI is attributed to housing. Of course, if a clear downtrend in inflation occurs it would change the trajectory of Fed policy.

This potential "slowing" of Fed hikes and the hope for a future pivot are what the markets have been looking for, and would provide a big boost for the prices of risk assets.

World Markets: 2022 Returns

Index	August	YTD 8/31/22
Brazil – Ibovespa	6.2%	4.5%
China – Shanghai Comp	-1.6	-12.0
Europe – Euro STOXX 50	-5.1	-18.2
India – S&P BSE SENSEX	3.4	2.2
Japan – Nikkei 225	1.0	-2.4
Mexico – Bolsa IPC	-6.7	-15.7
U.S. – S&P 500	-4.2	-17.0

Indices do not include dividends.

Focus on long term view

As you can see, forecasts are all over the board during this time of high uncertainty. Our view is that Mester is too negative, and Lee is way too upbeat. We see inflation falling more slowly during late 2022 and 2023 but approaching the Fed's two percent target by late next year. We also believe—after the Fed's strong rhetoric and another 75 basis points this month—that due to the favorable inflation trend they will be able to take their foot off the brake a little bit. This will allow stocks to reposition after this latest pullback and re-establish the gains made earlier this summer.

However, we are focusing more on the longer-term view currently. Historically, declines like we've seen so far this year have ended up being long-term buying opportunities. This inflation beast will take a while to wrestle to the ground. Getting back to two percent will probably take one and one-half years or so. But if a clear trend has been established, it won't take a trip all the way to two percent to push equity prices higher.

Yes, we still see some pain ahead. Undoubtedly there will be more volatility and probably a couple of tests of the June 16 lows. But as we said earlier, unless you have an extremely short-term investment time horizon or a low tolerance for risk, the advice is to "stay long."$

Model portfolios: We are watching our international positions very closely. The strength of the US dollar, the war in Ukraine, the European energy crisis, and uncertainty in China have put these holdings in question as we look forward. Keep an eye out for upcoming Hotlines and the October issue of MoneyLetter as we assess our allocative targets.

Brian has been a member of MoneyLetter's Investment Committee since 1986.

Rates as of 9/6/22

Years	MYGA Rate*	Treasury	CD
2	3.30% - 3.55%	3.25	3.05%
3	3.85% - 4.20%	3.44	3.46%
4	4.00% - 4.25%	--	3.25%
5	4.20% - 4.55%	3.42	3.25%
6	4.30% - 4.55%	--	--
7	4.30% - 4.65%	--	--

* A Multi Year Guaranteed Annuity (MYGA) is a hybrid of a fixed annuity and a CD. MYGAs guarantee a fixed rate for the entire duration of the contract term. Contact us for minimum premium requirements, state availablity and additional product details. CD rates provided by Bankrate.com.

(Tax Strategies, continued from page 4)

coverage). For couples filing jointly, each spouse gets hit with these higher amounts.

There are a few planning strategies you can use reduce or eliminate some of these unexpected taxes in retirement. We have discussed a few ideas in previous articles, such as Qualified Charitable Distributions, Charitable Giving, and Investment Tax Credits. As always, if you need help sorting through tax and retirement strategies, we're here to help. Also, you can download our free handy Tax Guide for 2022 at: **https://assetstrategy.com/wp-content/uploads/2022/02/AS-Tax-Guide-2022-1.pdf**

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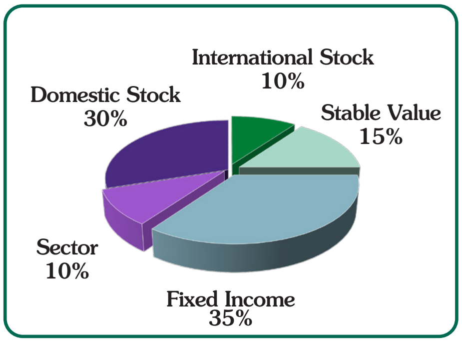
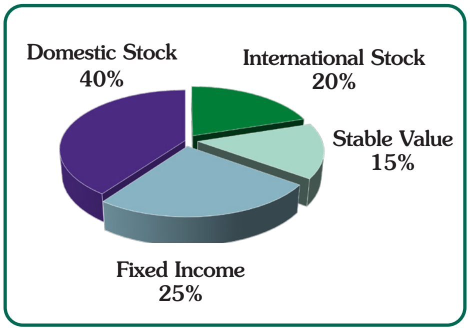


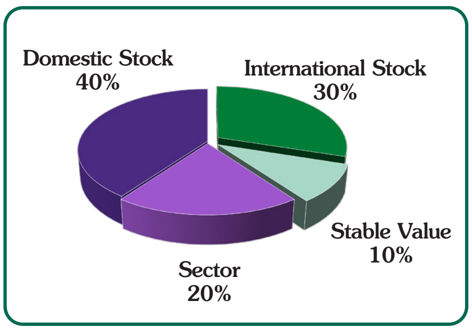
Conservative

The Conservative Model seeks steady long-term growth of capital with limited short-term volatility.



Moderate

The Moderate Model seeks greater long-term growth than the Conservative Model by taking prudent risks.



Venturesome

The Venturesome Model seeks maximum long-term growth by accepting greater short-term volatility.

What is MoneyLetter *Hi-Lites*?

✓ MoneyLetter Hi-Lites is a free educational and guidance resource for all retirement plan participants.

✓ It will enhance your experience as you move along your MyWealth Journey.

✓ MoneyLetter Hi-Lites is an important component of Asset Strategy's holistic approach to your overall financial health.

Unexpected Taxes in Retirement

By Sean Whalen, CFP®, MSF

When most people think of major retirement expenses, they often consider housing, healthcare, and that trip of a lifetime they've been dreaming about for years. But they often fail to consider what could potentially be their biggest expense – **taxes**. Keep in mind, many sources of income in retirement are taxable, so don't overlook these four unexpected taxes in retirement.

I. Tax on your Social Security benefit

Although you've paid into Social Security your entire working life, your benefit could be taxed, depending on your income. To figure out if your benefit will be taxed, add up your adjusted gross income, nontaxable interest, and half of your Social Security benefit to get your combined income. If your combined income as an individual is between $25,000 and $34,000 or between $32,000 and $44,000 as a married couple filing jointly, up to 50% of your benefit is taxable. And, if your combined income as an individual is over $34,000 or over $44,000 as a married couple filing jointly, up to 85% of your benefit is taxable.

Here's a tip: Each January, those taking Social Security will receive a Social Security Benefit Statement (Form SSA – 1099) showing the amount in benefits you received the previous year. You can use this Benefit Statement when you complete your federal income tax return to find out if your benefits are subject to tax.

If you currently live in the United States and you misplaced or didn't receive a Form SSA – 1099 or SSA – 1042S (for non-resident aliens) for the previous tax year, you can get a replacement by using your online my Social Security account at **www.ssa.gov**. If you don't already have an account, you can create one online. **Everyone should do this.** You can use your account to request a replacement Social Security card, check the status of an application, estimate future benefits, or manage the benefits you already receive. To get your replacement Form SSA – 1099 or SSA – 1042S, select the "Replacement Documents" tab.

II. RMDs could change your tax situation

Starting at age 72, you will most likely be required to take Required Minimum Distributions (RMDs) from your tax-deferred retirement accounts by April 1 of the next year. (For those of you born before July 1, 1949 the age is 70½ … you should already be taking your RMD). An RMD is the smallest amount you must withdraw every year after a certain age. After all, you postponed taxes on your contributions and earnings using these tax-deferred vehicles, you didn't eliminate them. RMDs are treated like any distribution from a traditional retirement account and are taxed as ordinary income. Consider how RMDs would impact your tax situation and potential "bracket creeps."

The amount you must withdraw every year is set by the IRS and could be higher than you want to distribute. The RMD for any year is calculated by taking the total account balance of all your non-Roth retirement accounts as of the end of the immediately preceding calendar year divided by a distribution period from the IRS's "Uniform Lifetime Table." This distribution could mean an increased tax burden. Age 72 is a birthday milestone that could change your tax situation, so plan for it.

Here's an example: If you're 80, the distribution period from the IRS table is 18.7 years. If you have a combined $400,000 in your tax-deferred retirement accounts, your RMD is $21,390.37 ($400,000 divided by 18.7). If you are in the 22 percent federal tax bracket, you'll owe $4,705.88 in federal taxes. **Don't forget the tax bite for your state as well!**

III. Inheriting or leaving an IRA?

As of 2019, most people who inherit a retirement account from someone other than their spouse must empty the account within 10 years of the original owner's death. This could mean paying more in tax than you originally anticipated. If you're planning to pass on a 401(k) or IRA to someone other than your spouse, you should keep this new rule in mind when creating your estate plan. There are tax minimization strategies for those inheriting and passing on retirement accounts.

Rather than waiting to pay more in taxes on your retirement income, you may be able to take steps to help reduce your tax burden for the long term. Tax minimization strategies could include converting all or part of a traditional tax-deferred retirement account to a Roth IRA. Make note: If you inherit a traditional, rollover, SEP, or SIMPLE IRA from a spouse, the most common result is to transfer the funds to your own IRA. This option is only available if you are the sole beneficiary.

IV. Don't forget the Medicare "surcharge"

Lastly, we should touch on the Medicare surcharge for high-income earners here, even if it is not typically referred to as a tax. In government-speak, the surcharge is called an "income-related monthly adjustment amount" or IRMAA. It is triggered when modified adjusted gross income—that's adjusted gross income plus tax-exempt interest income—exceeds $182,000 for a married couple filing jointly or $91,000 on an individual's return.

The surcharges rise in five steps. The highest-income beneficiaries pay $408.20 for Part B (medical insurance) and $77.90 on top of their premium for Part D (drug

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